Daily Comment

Confluence INVESTMENT MANAGEMENT

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[Posted: January 22, 2025 — 9:30 AM ET] Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 closed up 1.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.1%. Chinese markets were lower, with the Shanghai Composite down 0.9% from its previous close and the Shenzhen Composite down 1.0%. US equity index futures are signaling a higher open.

With 52 companies having reported so far, S&P 500 earnings for Q4 are running at $62.30 per share, compared to estimates of $64.79, which is up 11.7% from Q4 2023. Of the companies that have reported thus far, 86.5% have exceeded expectations while 13.5% have fallen short of expectations.

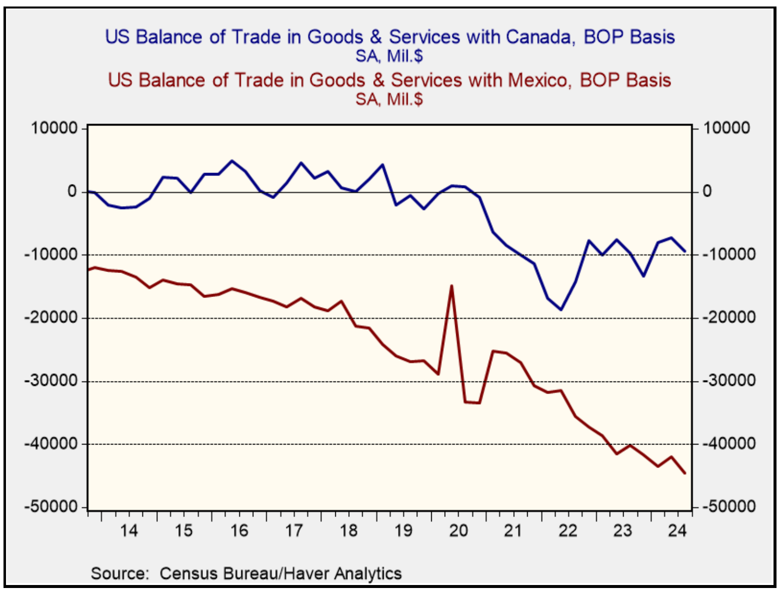
The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our website. We highlight recent publications below with new items of the day in bold:

Bi-Weekly Geopolitical Report	Asset Allocation Bi-Weekly	Asset Allocation Quarterly	Of Note
Syrian Surprise: Implications of a Sudden Regime Change (1/13/25) + podcast	*Magnificent 7 to the Rescue!* (1/21/25) + podcast	Q4 2024 Report Q4 2024 Rebalance Presentation	*The 2025 Outlook: A Year of Political and Policy Change*

Good morning! Markets are paying close attention to the new president. In sports, Ichiro Suzuki, CC Sabathia, and Bill Wagner were inducted into the National Baseball Hall of Fame. Today's *Comment* covers Trump's first few days in office, including his threats of higher taxes on foreign nationals, tariffs on US allies, and the White House's push for AI. We'll also review key domestic and international data releases and other market-moving developments.

Trump 2.0 Begins: President Trump has offered more details on his plans to deal with the rest of the world. These proposed changes include potential taxes on foreign multinational corporations and new tariffs. The announcements positively impacted the stock market, notably boosting equities of small and mid-cap companies, and also contributing to a rise in long-term bond prices.

- The 47th US president has criticized other nations for imposing so-called "extraterritorial taxes" on American companies. Trump argues that Western countries are unfairly targeting US businesses and has vowed to retaliate by doubling taxes on foreign nationals and companies. He referenced a 90-year-old provision in Section 831 of the US tax code that permits retaliatory taxes on foreign entities.
- Regarding tariffs, the president avoided a blanket tax on imports from all nations, instead threatening targeted tariffs specifically against countries involved in the fentanyl trade. He said he would add a 25% tariff to all goods from Mexico and Canada if they don't take action to stop the flow of illegal immigrants and illicit drugs. Additionally, he also mentioned a modest 10% tariff on Chinese goods for China's role in the drug trade. This new tariff would start on February 1.
- This shift toward a more assertive stance with US allies likely reflects the president's efforts to solidify a transition from a benevolent global leader to a more transactional one. Consequently, the US may be less inclined to offer preferential trade terms to its allies and could potentially reassess its security commitments.

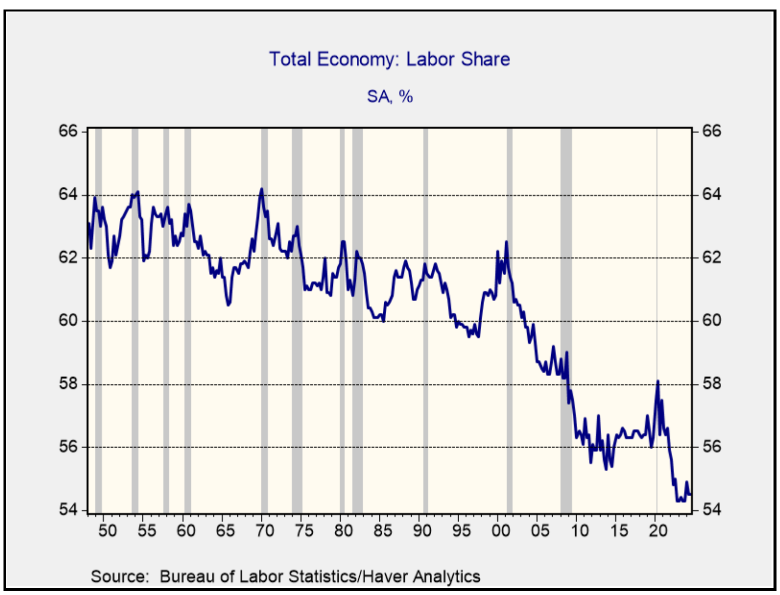


- American allies have signaled a willingness to collaborate with the US on certain issues but have also warned of potential pushback. Mexican President Claudia Sheinbaum affirmed her intent to work with the US while emphasizing her commitment to defending Mexico's sovereignty. Canadian Prime Minister Justin Trudeau stated that Canada would respond decisively to any unfair tariffs.
- The president's more assertive approach towards US allies may initially have a positive impact on equity and bond yields, provided his rhetoric remains largely posturing and does not provoke significant retaliation. However, in the long term, this isolationist trajectory could negatively impact the US economy. While equities may remain relatively

resilient, a prolonged period of increased geopolitical tension and economic decoupling could ultimately trigger a bear market in bonds.

AI Taking Next Steps: The administration's plans to boost AI infrastructure investment to $500 billion and relax regulations have been met with enthusiasm from the tech industry. However, growing apprehension is evident among other groups concerned about the potential consequences of this rapid advancement.

- On Monday, the president took several actions aimed at accelerating AI development. He signed an executive order that would relax safety and transparency regulations for AI systems. Additionally, he announced a public-private partnership with Softbank, OpenAI, and Oracle Corporation to develop advanced AI technologies. Finally, he signed another executive order authorizing the release of federal land for the construction of data centers.
- Furthermore, the president has expressed a willingness to facilitate increased energy access for these companies to support their growing data center needs. While not explicitly mentioning nuclear power, he indicated an openness to exploring options that allow these firms to generate their own energy solutions.
- NIMBY (not in my backyard) opposition had previously hindered AI development, as several communities have resisted their local governments' efforts to permit the construction of data centers within their area.



- Additionally, concerns about job displacement due to technological advancements are growing. On Tuesday, Kevin Weil, Chief Product Officer at OpenAI, warned of the imminent arrival of AI agents. These sophisticated AI systems will be capable of performing complex tasks, potentially automating many white-collar jobs.
- While AI is poised to play an increasingly significant role in the economy, its development and deployment are likely to become increasingly politicized in the coming

years. Although the president currently appears supportive of the tech industry, we anticipate that the sector is still under threat of higher political scrutiny.

Energy Deregulation Hopes: As anticipated, the president withdrew the United States from the Paris Climate Accords and declared a national energy emergency. This policy shift has fueled optimism among some that increased energy production will lead to lower energy and input costs.

- The president has expressed a desire to increase domestic oil and gas production, aiming to bolster US manufacturing. To this end, he signed an executive order that would ease environmental regulations, facilitating the construction of new energy production facilities and enabling drilling in previously protected areas.
- While the president has prioritized oil and gas production, other sectors also anticipate benefiting from his deregulatory agenda. Rio Tinto, a major copper mining company, has expressed optimism that the administration will approve its plans to expand copper mining operations in Arizona. The company aims to supply 25% of the country's growing demand for copper.

Panama Canal Takeover: The United States' desire to reclaim control of the Panama Canal is raising international concerns.

- Earlier today, the Panamanian president dismissed anxieties that the US might attempt a forceful takeover. Additionally, Russia has also publicly stated its interest in ensuring the canal's continued neutral status.
- The ongoing dispute over the Panama Canal, a vital conduit for global trade, is likely to fuel concerns about potential disruptions to supply chains and an escalation of geopolitical tensions. Therefore, we will be closely monitoring this evolving situation.

US Economic Releases

The Mortgage Bankers Association today said mortgage applications for the week ended January 17 were essentially flat, registering a 0.1% rise. This comes after a more volatile set of recent weeks, including the previous week's 33.3% rise. Applications for home purchase mortgages rose a modest 0.6%, after rising 26.9% the prior week. Meanwhile, applications for refinancing mortgages fell 2.9%, after rising 43.5% the prior week. According to the report, the average interest rate on a 30-year mortgage eased 7 basis points to 7.02%, marking an end to what had been a six-week rising trend.

The table below lists the economic releases and Fed events scheduled for the rest of the day.

Economic Releases						
ET	Indicator			Expected	Prior	Rating
10:00	Leading Index	m/m	Dec	-0.1%	0.3%	***
Federal Reserve						
No Fed speakers or events for the rest of today						

Foreign Economic News

We monitor numerous global economic indicators on a continuous basis. The most significant international news that was released overnight is outlined below. Not all releases are equally significant, thus we have created a star rating to convey to our readers the importance of the various indicators. The rating column below is a three-star scale of importance, with one star being the least important and three stars being the most important. We note that these ratings do change over time as economic circumstances change. Additionally, for ease of reading, we have also color-coded the market impact section, which indicates the effect on the foreign market. Red indicates a concerning development, yellow indicates an emerging trend that we are following closely for possible complications, and green indicates neutral conditions. We will add a paragraph below if any development merits further explanation.

Country	Indicator			Current	Prior	Expected	Rating	Market Impact
ASIA-PACIFIC								
Australia	Westpac Leading Index	m/m	Dec	-0.20%	0.60%		**	Equity and bond neutral
New Zealand	CPI	y/y	4Q	2.2%	2.2%	2.1%	**	Equity and bond neutral
South Korea	Consumer Confidence	m/m	Jan	91.2	88.2		*	Equity and bond neutral
EUROPE								
UK	Public Finances (PSNCR)	m/m	Dec	19.9b	13.1b		*	Equity and bond neutral
	Public Sector Net Borrowing	m/m	Dec	17.8b	11.8b	14.2b	*	Equity and bond neutral
	PSNB ex Banking Groups	m/m	Dec	17.8b	11.8b		**	Equity and bond neutral
AMERICAS								
Canada	CPI	y/y	Dec	1.8%	1.9%	1.9%	***	Equity and bond neutral
Mexico	International Reserves Weekly	w/w	17-Jan	$22905b	$228921m		*	Equity and bond neutral

Financial Markets

The table below highlights some of the indicators that we follow daily. Again, the color coding is similar to the foreign news description above. We will add a paragraph below if a certain move merits further explanation.

Fixed Income	Today	Prior	Change	Trend
3-mo T-bill yield (bps)	421	420	1	Down
U.S. Sibor/OIS spread (bps)	430	430	0	Down
U.S. Libor/OIS spread (bps)	432	432	0	Down
10-yr T-note (%)	4.57	4.58	-0.01	Down
Euribor/OIS spread (bps)	268	268	0	Down
Currencies	**Direction**			
Dollar	Up	US		Down
Euro	Down	Euro		Up
Yen	Down	Japan		Up
Pound	Down	UK		Up
Franc	Down	Switzerland		Up

Commodity Markets

The commodity section below shows some of the commodity prices and their change from the prior trading day, with commentary on the cause of the change highlighted in the last column.

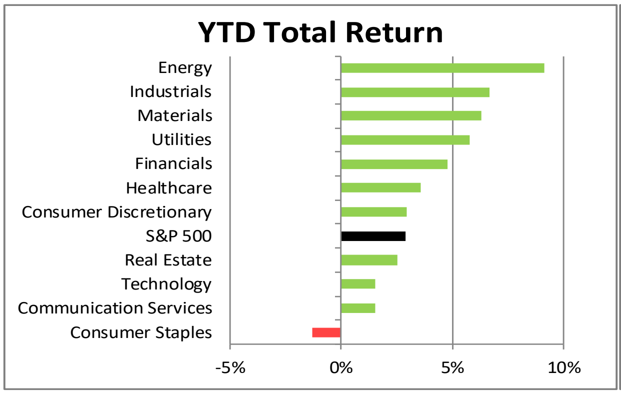
	Price	Prior	Change	Explanation
Energy Markets				
Brent	$79.28	$79.29	-0.01%	
WTI	$75.78	$75.83	-0.07%	
Natural Gas	$3.75	$3.76	-0.05%	
Crack Spread	$18.29	$18.28	0.06%	
12-mo strip crack	$21.38	$21.39	-0.05%	
Ethanol rack	$1.81	$1.81	-0.01%	
Metals				
Gold	$2,758.51	$2,744.81	0.50%	
Silver	$30.78	$30.78	-0.02%	
Copper contract	$430.95	$434.10	-0.73%	
Grains				
Corn contract	$488.00	$490.00	-0.41%	
Wheat contract	$558.50	$558.75	-0.04%	
Soybeans contract	$1,060.75	$1,067.25	-0.61%	
Shipping				
Baltic Dry Freight	928	957	-29	
DOE Inventory Report				
	Actual	**Expected**	**Difference**	
Crude (mb)		0.60		
Gasoline (mb)		2.17		
Distillates (mb)		0.58		
Refinery run rates (%)		-1.0%		
Natural gas (bcf)		-260		

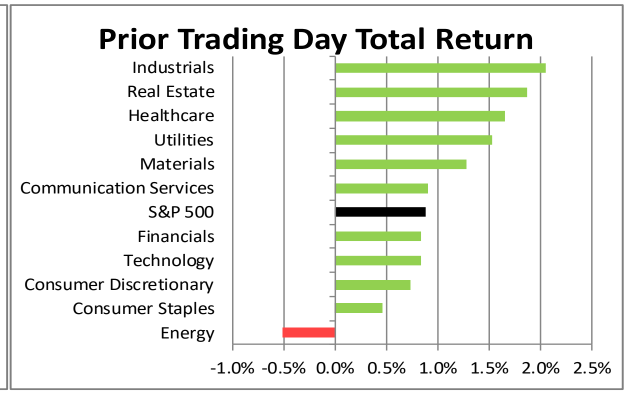
Weather

The 6-to-10-day and 8-to-14-day forecasts currently call for warmer-than-normal temperatures in southern Florida and the northern Great Plains, with cooler-than-normal temperatures in New England, southern California, and the Pacific Northwest. The forecasts call for wetter-than-normal conditions in the southern Mississippi Valley and the Lake Superior region, with dry conditions in an area of the West stretching from California to Nebraska.

Data Section

US Equity Markets – (as of 1/21/2025 close)

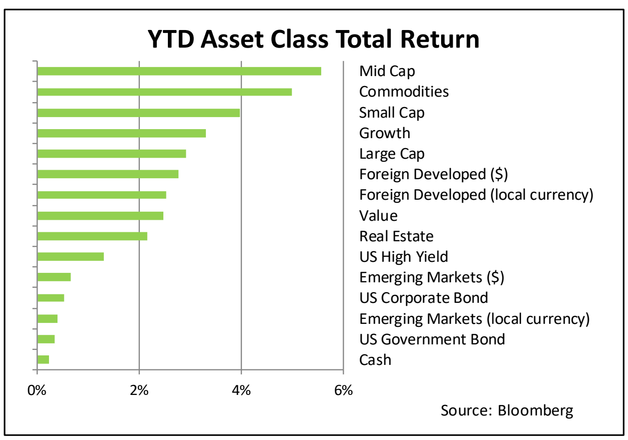




(Source: Bloomberg)

These S&P 500 and sector return charts are designed to provide the reader with an easy overview of the year-to-date and prior trading day total return. Sectors are ranked by total return; green indicating positive and red indicating negative return, along with the overall S&P 500 in black. These charts represent the new sectors following the 2018 sector reconfiguration.

Asset Class Performance – (as of 1/21/2025 close)

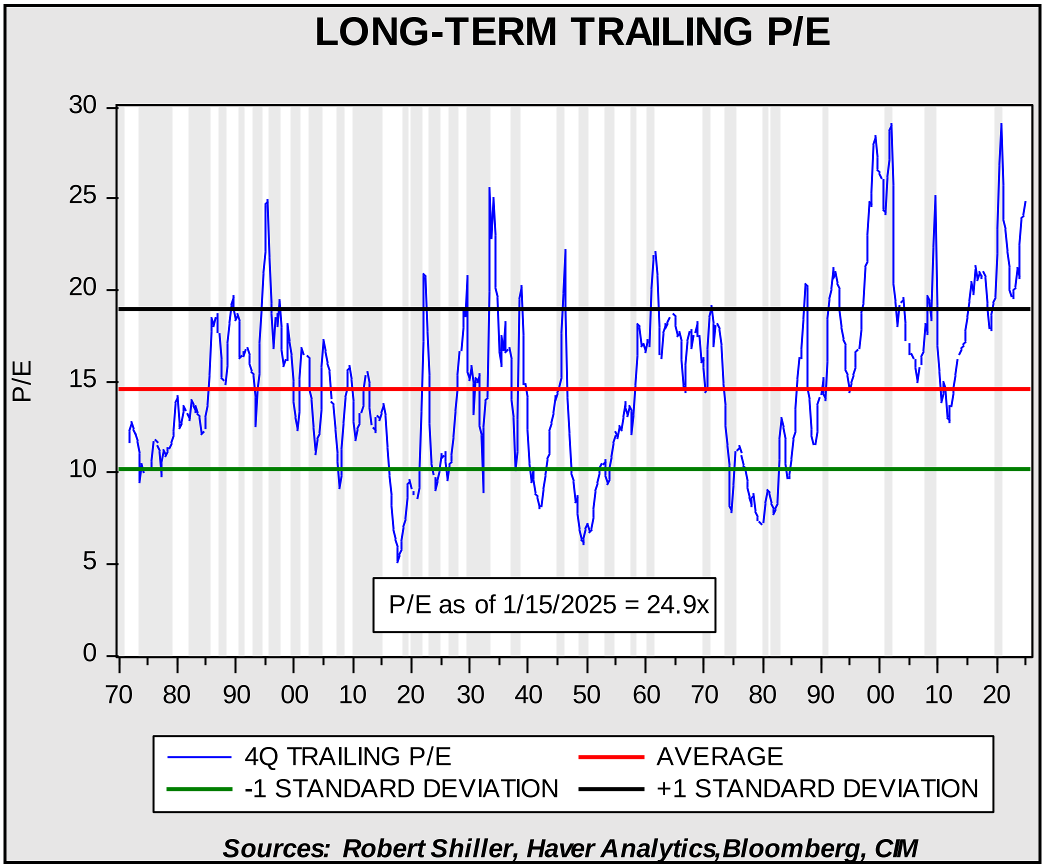


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

Asset classes are defined as follows: Large Cap (S&P 500 Index), Mid Cap (S&P 400 Index), Small Cap (Russell 2000 Index), Foreign Developed (MSCI EAFE (USD and local currency) Index), Real Estate (FTSE NAREIT Index), Emerging Markets (MSCI Emerging Markets (USD and local currency) Index), Cash (iShares Short Treasury Bond ETF), US Corporate Bond (iShares iBoxx $ Investment Grade Corporate Bond ETF), US Government Bond (iShares 7-10 Year Treasury Bond ETF), US High Yield (iShares iBoxx $ High Yield Corporate Bond ETF), Commodities (Bloomberg total return Commodity Index), Value (S&P 500 Value), Growth (S&P 500 Growth).

P/E Update

January 16, 2025



Based on our methodology,[1] the current P/E is 24.9x, down 0.1 from our last report. The decrease was due to a decline in the stock price index.

This report was prepared by Confluence Investment Management LLC and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change. This is not a solicitation or an offer to buy or sell any security.

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[1] This chart offers a running snapshot of the S&P 500 P/E in a long-term historical context. We are using a specific measurement process, similar to *Value Line*, which combines earnings estimates and actual data. We use an adjusted operating earnings number going back to 1870 (we adjust as-reported earnings to operating earnings through a regression process until 1988), and actual operating earnings after 1988. For the current quarter, we use the Bloomberg estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes three actual quarters (Q1, Q2 and Q3) and one estimate (Q2). We take the S&P average for the quarter and divide by the rolling four-quarter sum of earnings to calculate the P/E. This methodology isn't perfect (it will tend to inflate the P/E on a trailing basis and deflate it on a forward basis), but it will also smooth the data and avoid P/E volatility caused by unusual market activity (through the average price process). Why this process? Given the constraints of the long-term data series, this is the best way to create a long-term dataset for P/E ratios.